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Uncertainty in the Eurobond Market

E.C. LASHBROOKE, JR.*

I. INTRODUCTION

The Eurobond market has existed for nearly twenty years, long after the circumstances giving rise to its creation ceased to exist. The outward appearance of the Eurobond market's stability is deceiving, and there are fears for its continuing viability as a capital market for United States enterprises.

The Eurobond market is not without risk, and investors fear that unilateral regulation, primarily by the Securities and Exchange Commission (Commission), is imminent. Registration of Eurobonds with the Commission will increase the cost and substantially alter the timing and flexibility of the issuer in issuing Eurobonds. Moreover, registration subjects the foreign issuer to the disclosure requirements of the federal securities laws and to potential financial liability for violation of these laws.

Favorable tax treatment is critical in the decision to issue Eurobonds. Currently, entry into the Eurobond market by United States enterprises is through the Netherlands Antilles which accords favorable tax treatment to its corporations. The United States-Netherlands Antilles tax treaty¹ provides for exemption from the withholding tax requirements of Sections 1441 and 1442 of the Internal Revenue Code.² This exemption is necessary to effectively market a Eurobond. Investor fears are spurred by the pending renegotiation of the United States-Netherlands Antilles tax treaty. The Eurobond market's position *vis-à-vis* these recent events is the subject of this article.

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1. Income Tax Convention, Apr. 29, 1948, United States-Netherlands, 62 Stat. 1757, T.I.A.S. No. 1855, T.D. 5778, 1950-1 C.B. 92, *extended to* the Netherlands Antilles by protocol of June 15, 1955, 6 U.S.T. 3696, T.I.A.S. No. 3366, T.D. 6153, 1955-2 C.B. 777, *modified and supplemented* by protocol of October 23, 1963, 15 U.S.T. 1900, T.I.A.S. No. 5665, 1965-1 C.B. 624.

2. *Id.* I.R.C. §§ 1441, 1442 (West 1982).

II. BACKGROUND

A. Post-War History of United States' Role in the International Capital Market

Following World War II and until 1963, New York City was the primary international capital market place. Coexistent with the honor of being the primary international capital market was the concomitant outflow of United States dollars. In only one year (1957) during the period from 1950 through 1963 was there a surplus in the United States' balance-of-payments.³ During the same period, the highest deficit in overall balance-of-payments was \$3.9 billion, in 1960.⁴ These figures alarmed both the Legislative and Executive Branches.

Of particular concern⁵ was the increasing investment in foreign securities by United States residents.⁶ New issues of foreign securities held by United States residents in 1962 totaled almost \$1.1 billion and 1963 projections predicted an annual rate of \$2 billion.⁷ The increase in sales of foreign securities to United States' residents in the early 1960s was the combined result of lower interest rates in the United States relative to most other industrialized countries and the inability of Western European capital markets to supply the demands of European businesses.⁸ Foreign securities were more attractive to United States residents than domestic securities because the investments' rate of return on foreign securities was higher than on domestic securities.

Congressional response came in 1964 and was designed to effectively equalize United States and foreign interest rates. The Interest Equalization Tax Act of 1963⁹ was enacted in 1964 and was, by its terms, retroactive to July 19, 1963, the day after the proposal was submitted to Congress. A temporary excise transfer tax was imposed on the actual value of debt obligations of a foreign obligor or stock

3. S. REP. NO. 1267, 88th Cong., 2d Sess. (1964), *reprinted in* 1964 U.S. CODE CONG. & AD. NEWS 3478, 3479.

4. *Id.*

5. *Id.* at 3482.

6. A resident is a United States citizen or resident alien. A resident is defined as a person actually present in the United States who is not a mere transient or sojourner. Treas. Reg. § 1.871-2(b)(19) (1961).

7. S. REP. NO. 1267, *supra* note 3, at 3482.

8. *Id.* at 3484.

9. Pub. L. No. 88-563, 78 Stat. 809 (1964), *codified as* I.R.C. §§ 4911-4920, 4931, 6076, 6680, 6681, 7241 (repealed 1976).

of a foreign issuer acquired from a foreign person.¹⁰ The maximum tax rate was fifteen percent and varied primarily depending on the term of the obligation.¹¹ The rates were determined by adding one percent to the United States interest rate to determine its equivalent present value.¹² In effect, the cost of raising capital in the United States increased by one percent since a United States taxpayer would not invest in a foreign security unless the foreign issuer assumed the burden of the added cost of the tax to the United States taxpayer. Sales of foreign securities began to fall immediately after the bill¹³ was introduced.¹⁴

In 1968 President Johnson issued Executive Order 11,387,¹⁵ which prohibited transactions involving transfer of capital to or within a foreign country, or to any foreign national outside the United States by an owner, subject to United States jurisdiction, of a ten percent or more interest in voting securities, capital, or earnings of a foreign business.¹⁶ As a result of Executive Order 11,387, small investors could still buy foreign securities, but the large block investors, particularly institutional investors, were shut out of the foreign securities market.¹⁷

Primarily due to the Interest Equalization Tax Act of 1963, Executive Order 11,387, and the Foreign Direct Investment Regulations¹⁸ issued pursuant to the Executive Order, New York ceased to be an international capital market. Another source of capital had to be found. The markets that ultimately developed were the Eurobond and Eurodollar markets.

B. Eurobonds and Eurodollars as New Sources of Capital

Under the Marshall Plan following World War II, the United States pumped immense sums of money into the economies of Western

10. I.R.C. § 4911 (repealed 1976).

11. *Id.*

12. S. REP. NO. 1267, *supra* note 3, at 3485.

13. H.R. 8000, 88th Cong. 1st Sess. 110 CONG. REC. 4515-23 (1964).

14. The bill was introduced in the House in August, 1963. "In the third quarter of 1963 [August, September, and October] . . . net purchases of foreign stocks and bonds result[ed] in a favorable balance of \$51 million." H.R. 1046, 88th Cong., 1st Sess. 6 (1963).

15. 33 Fed. Reg. 47 (1968) *revoked*, 39 Fed. Reg. 86,481 (1974)).

16. *Id.*

17. The importance of this is seen when considering that institutions account for the placement of 80% of Eurodollar bonds. *The Eurobond Market*, THE ECONOMIST, Nov. 18, 1978, at 114, col. 3.

18. 15 C.F.R. §§ 1000-1050 (1974).

industrialized nations.¹⁹ The goal of the Marshall Plan was to resurrect the devastated economies of non-communist countries and to prevent their collapse and loss to communism. This pool of United States dollars, added to trade deficits, created the overseas reserves of United States dollars which became the Eurodollar and Eurobond markets.

In the post-war period from 1949 to 1962, the annual deficit in overall balance-of-payments never exceeded \$4 billion.²⁰ From 1952 through 1973 United States oil imports ranged from \$.69 billion (c.i.f.) to \$7.55 billion (c.i.f.).²¹ After the Arab oil embargo of 1973, spectacular growth in the Eurodollar and Eurobond markets occurred. In 1974, the value of oil imports jumped to \$26.12 billion (c.i.f.) and increased until 1981 when the value was \$79.70 billion (c.i.f.).²² These petrodollars inflated the pool of United States dollars available to the Eurodollar and Eurobond markets.

C. The History of the Eurodollar

Essentially, a Eurodollar is any deposit of United States' dollars in a banking institution outside the territorial jurisdiction of the United States. The banking institution may be either a foreign bank or an overseas branch of a United States bank. The growth of the Eurodollar and Eurobond markets caused the explosion of overseas branches of United States banks in the early 1970's.²³

United States banking policy decisions forced United States banks to open foreign branch offices. Federal Reserve Board Regulation Q prohibited interest payments on demand deposits, and limited the interest rate on time deposits.²⁴ As a result of Regulation Q, the interest rate obtainable in the United States is lower than the Eurobond interest rate.²⁵ In addition, foreign branches of United States banks are not subject to the reserve requirements of the Federal Reserve

19. The Marshall Plan or European Recovery Program was first outlined in a commencement address on June 5, 1947 by Secretary of State George C. Marshall. Legislation establishing the Economic Cooperation Administration (ECA) was enacted in 1948. During the tenure of the ECA (1948-52) over \$12 billion was dispensed under the Marshall Plan.

20. S. REP. NO. 1267, *supra* note 3, at 3479.

21. International Financial Statistics, [1982] INT'L MONETARY FUND Y.B. 466-67.

22. *Id.*

23. See International Financial Statistics, [1982] INT'L MONETARY FUND Y.B.

24. 12 C.F.R. §§ 217.3, 217.4 (1983).

25. See International Financial Statistics, [1982] INT'L MONETARY FUND Y.B. 56, for a comparison of interest rates between the United States and the London Eurobond market.

Board.²⁶ None of the deposits of foreign branches need be idle.

A Eurodollar transaction is a loan made outside the United States and repaid by the debtor outside the United States. Long term loan transactions in which unsecured corporate notes are issued constitute the Eurobond market. Because the Eurobond market is truly international and not unilaterally regulated, the terms and conditions under which the loan is made and the bonds are issued are nearly uniform.²⁷ Uniformity is the result of the issuers' collective need for certainty and security in a crazy quilt of national law and interests.

D. The History of Eurobonds

A Eurobond is comparable to a note or bond issued in the United States. The typical Eurobond is a European-style bearer instrument generally in denominations of \$1000.²⁸ Investors prefer bearer instruments to protect anonymity and to facilitate transfer.²⁹

Because the note or bond is a security,³⁰ United States based corporations cannot directly issue the Eurobonds without registration under the provisions of the Securities Act of 1933 (33 Act).³¹ To avoid registration, United States based corporations create foreign finance subsidiaries which issue the notes or bonds.³² To facilitate their sale, the United States based parent corporation may guarantee the bonds. The proceeds from the sale of the Eurobonds are, in turn,

26. Section 7, International Banking Act of 1978, 12 U.S.C. § 3105; 12 C.F.R. § 204.9(a)(2) (1983).

27. See Horn, *A Uniform Approach to Eurobond Agreements*, 9 LAW & POL'Y IN INT'L BUS. 753, 756-57 (1977).

28. Bross, *The United States Borrower in the Eurobond Market — A Lawyer's Point of View*, 34 LAW & CONTEMP. PROBS. 172, 181 (1969).

29. *Id.* Anonymity works both ways. The issuer may prefer that the purpose of the issue remain undisclosed. For example, an issuer arranging financing for an attempted merger or takeover may utilize the Eurobond market rather than domestic financing where use of the proceeds must be disclosed in Item 3, form S-1 registration statement. *Id.* at 176-77; 17 C.F.R. § 239.11 (1983). On the other hand the purchaser may prefer to remain anonymous particularly if the purchaser wants to avoid municipal law. OPEC leaders seem to prefer being secretive about their investments.

The Treasury is hostile to bearer form obligations. If interest is attributable to certain obligations in bearer form the interest deduction may be denied. I.R.C. § 164(f)(19) (West 1978). A loss sustained on bearer form obligations may not be deductible. I.R.C. § 165(j)(19) (West Supp. 1983). Gain on sale or exchange of a bearer form obligation may be treated as ordinary income. I.R.C. § 1232(c) (West 1982).

30. The Securities Act of 1933 defines a security as "any note, . . . bond, debenture, evidence of indebtedness, . . . or . . . guarantee of, . . . any of the foregoing." Securities Act of 1933, § 2(1), 15 U.S.C. § 77b(1) (1981).

31. 15 U.S.C. § 77(e) (1976).

32. Bross, *supra* note 28, at 188.

loaned by the foreign subsidiary to the parent corporation.

The Eurobond market has grown primarily because it avoids contact with United States securities laws while directly competing with the United States capital markets for investment dollars. Eurobonds have an advantage over United States securities because the bonds may be issued in response to need without registration delays and, as a result, may be less expensive. Other factors which have contributed to the growth of the Eurobond market are the more favorable interest rate, corporate guarantee, the anonymity and liquidity of bearer type instruments, and the favorable tax treatment.

The Eurobond market, however, is not without risk. Wide fluctuations in Eurocurrency might cause the market to operate erratically and create a credit crunch. The oil glut and decreased consumption of petroleum products are drying up OPEC petrodollars which constitute a major source of available dollars to buy Eurobonds.³³

III. UNITED STATES REGULATION OF FOREIGN ISSUED SECURITIES

A. *Registration of Eurobonds*

In the absence of a statutory exemption,³⁴ Eurobonds are securities which require registration pursuant to the 33 Act.³⁵ Since the Commission has taken the position that the Securities Acts were designed to protect United States citizens and residents,³⁶ registration of Eurobond issues is not required, provided that the Eurobonds are offered outside the United States only to non-nationals of the United States and Canada, and as long as the distribution is effected in a manner which would result in the securities coming to rest outside the United States.³⁷ Since 1964, Eurobond issues have been offered outside the United States in reliance on Securities Act Release No.

33. Alm, *It Might Help Now, But in Time . . .* N.Y. Times, Dec. 12, 1982, § F, at 2, col. 3; Lichtblau, *OPEC's Humbling Could Be a Problem*, N.Y. Times, Dec. 12, 1982, § F, at 2, col. 5.

34. Some of these exemptions are found in 15 U.S.C. § 77c (1976 & Supp. 1981). Exempted transactions are found in 15 U.S.C. § 77d (1976 & Supp. 1981).

35. 15 U.S.C. §§ 77a-77mm (1976 & Supp. 1981).

36. SEC Securities Act Release No. 4708 (July 9, 1964), 29 Fed. Reg. 9828 (1964), reprinted in 1 FED. SEC. L. REP. (CCH) ¶¶ 1361-63, at 2124.

37. *Id.*

4708.³⁸ To comply with the release, underwriting agreements generally provide for a ninety day lock-up to prevent the securities from coming to rest in the United States for at least the initial ninety day period.³⁹

No-action letters issued by the Commission do not offer opinions with respect to resales in the United States after the expiration of the ninety day period but are limited to the initial distribution outside the United States.⁴⁰ However, the Commission states that reoffers and resales must be made in compliance with the registration requirements of the Securities Act.⁴¹ The end result is that registration is required unless an exemption is available.

Currently, a registration exemption is available to foreign issuers who involuntarily enter the United States market.⁴² However, the Commission has proposed eliminating this exemption.⁴³ Rule 12g3-2⁴⁴ allows these foreign securities to be traded over-the-counter and quoted on the NASDAQ listing.⁴⁵ The proposed amendments would treat the NASDAQ listing as a voluntary entry into the United States market so that foreign issuers with NASDAQ quoted securities would not be involuntary participants in the United States market and would, therefore, not be exempt from registration requirements.⁴⁶

38. See, e.g., Intercontinental Hotels Corp., no-action letter (dated July 12, 1971), reprinted in [1971-1972 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 78,370; The Singer Co., no-action letter (dated Sept. 3, 1974), reprinted in [1974-1975 Transfer Binder] FED. SEC. L. REP. ¶ 79,979.

39. See, e.g., The Singer Co., letter of inquiry (dated July 25, 1974), reprinted in [1974-1975 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 79,979 at 84,516-19.

40. A "no-action" letter is a Securities and Exchange Commission staff reply to an inquiry that, based on the facts supplied, the staff will not recommend that action be taken by the Commission. See, e.g., The Singer Co., *supra* note 39, at 84,515.

41. *Id.*

42. SEC Securities Act Release No. 6433 (Oct. 28, 1982) and SEC Securities Exchange Act Release No. 19,187 (Oct. 28, 1982), reprinted in [1982 Transfer Binder] FED. SEC. L. REP. (CCH) ¶ 83,272. Under Rule 12g3-2, a foreign issuer could encourage a secondary market through the NASDAQ system without registration or disclosure. 17 C.F.R. § 240.12g3-2 (1982).

43. Under the proposed amendments foreign issuers whose securities are listed on NASDAQ must comply with an annual disclosure requirement. The "pink sheet" market or National Daily Quotation Sheets remains available to foreign issuers without registration or annual disclosure. *Id.*

44. *Id.*

45. National Association of Securities Dealers Automated Quotation system provides current quotations for many over-the-counter securities.

46. SEC Securities Act Release No. 6433 and SEC Securities Exchange Act Release No. 19,187, *supra* note 42.

Convertible Eurobonds issued by foreign finance subsidiaries of United States domestic corporations create additional problems. While the Eurobond itself need not be registered under current Commission practice, the underlying security of the United States corporation must be registered.⁴⁷ Section 3(a)(9)⁴⁸ of the 33 Act, which provides an exemption for securities exchanged by an issuer with its existing security holders, does not provide the United States corporation with an exemption here because the convertible Eurobonds are issued by the foreign finance subsidiary and not the United States parent corporation, which merely guarantees the Eurobond. Therefore, it is not an exchange of securities by an issuer with its existing shareholders.

If the Commission should change its position taken in the no-action letters and require registration, or should it finally decide to require secondary distribution registration, the issuer, underwriters and sellers would be in violation of section 5⁴⁹ of the 33 Act. Such a change in position would seriously impede the flow of international capital into the United States because of the increased cost of registration, increased lead time required to obtain Commission approval, the reluctance of foreign issuers to disclose sensitive information in public registration materials and exposure to the potential financial liability for misstatements or omissions in the registration materials and selling documents.

Foreign issuers may easily register their securities by filing the appropriate form.⁵⁰ Forms F-1,⁵¹ F-2,⁵² and F-3⁵³ for foreign private

47. SEC Form F-1, 47 Fed. Reg. 54,771, 54,772 (1982) (to be codified at 17 C.F.R. § 239.31).

48. 15 U.S.C. § 77(c)(a)(9) (1981).

49. 15 U.S.C. § 77(e) (1976).

50. In 1982, the Commission modified forms S-1, S-2 and S-3. 17 C.F.R. § 239.13 (1982), in SEC Securities Act Release No. 6383 (May 24, 1982), 47 Fed. Reg. 11,380 (1982) and created forms F-1, F-2 and F-3, 47 Fed. Reg. 54,771-79 (1982), for use of foreign private issuers in SEC Securities Act Release No. 6437 (Dec. 4, 1982), and SEC Securities Exchange Act Release No. 19,258 (Dec. 4, 1982), 47 Fed. Reg. 54,764 (1982).

51. SEC Form F-1, 47 Fed. Reg. 54,771 (1982), 2 FED. SEC. L. REP. (CCH) ¶ 6038D. Form F-1 must be used by foreign private issuers for all offers including exchange offers except for those which qualify to use form F-2 or F-3. Form F-1 requires the greatest degree of disclosure of the three forms because of the foreign private issuer's lack of contact with the United States reporting systems. Form F-1 must be used by foreign private issuers (1) who are "world class" issuers (issuers having an aggregate market value of voting stock held by non-affiliates worldwide of at least \$300 million) or who are making a shareholder offering and who have not reported under section 12 (15 U.S.C. § 78l (1981)), section 13 (15 U.S.C. § 78m (1981)), section 14 (15 U.S.C. § 78n (1981)), or section 15(d) (15 U.S.C. § 78o(d) (1981)) of the Securities Exchange Act of 1934 (34 Act) for the thirty-six month period immediately preceeding the filing of the form F-1 and who have not filed an annual report pursuant to Rule 12b-25(b) (17 C.F.R. § 240.12b-25(b) (1983)), and (2) who are

issuers parallel forms S-1,⁵⁴ S-2⁵⁵ and S-3,⁵⁶ which are required for United States issuers. In order to use the F-series forms, the foreign private issuer must be eligible to file or have filed a Form 20-F.⁵⁷ United States parent corporations and their wholly-owned foreign finance subsidiaries may not use form F-1, F-2 or F-3 to register securities for sale in the United States but must use form S-1, S-2 or S-3.⁵⁸

making other offerings and who have not filed reports pursuant to sections 12, 13, 14 or 15(d) of the 34 Act for the thirty-six month period immediately preceeding the filing of F-1. Form F-1 must be used by a foreign private issuer eligible to use an SEC Form 20-F but for which no other form is prescribed. Form F-1 requires financial information substantially the same as that required of domestic corporations which includes use of United States accounting standards and techniques in preparing and presenting the financial data. The increased reporting requirement of Form F-1 seems to be an extension of the Commission's preoccupation with the stilted disclosure forms of the past primarily designed to protect the individual investor. Eurobond issues resold in the United States would be directed primarily at the institutional investor who has the means to acquire relevant information before making the purchase.

52. SEC Form F-2, 47 Fed. Reg. 54,773 (1982), 2 FED. SEC. L. REP. (CCH) ¶ 6038E. Form F-2 may be used by a foreign private issuer who has a class of securities registered under section 12(b) of the 34 Act or a class of equity securities registered under section 12(g) of the 34 Act or is required to file reports under section 15(d) of the 34 Act and is eligible to file and has filed annual reports on form 20-F; provided, the foreign private issuer is a "world class" issuer who has filed at least the latest form 20-F required to have been filed and the securities are only offered to existing shareholders. Other offerings by a non "world class" issuer may be registered on form F-2 only if the issuer has filed reports pursuant to sections 13, 14 or 15(d) of the 34 Act for the thirty-six month period immediately preceeding the filing of form F-2. Because of the reporting requirements for use of the form F-2 it is an intermediate disclosure form requiring less disclosure than form F-1 where the issuer has no reporting history.

53. SEC Form F-3, 47 Fed. Reg. 54,776 (1982), 2 FED. SEC. L. REP. (CCH) ¶ 6038F. Form F-3 is the minimal disclosure form for foreign private issuers. Form F-3 is primarily to be used by "world class" issuers who have met the thirty-six month and annual reporting requirements. The world class issuer requirement is imposed on transactions involving secondary offerings; however, the world class issuer requirement does not apply to offerings of non-convertible "investment grade" debt securities offered for cash. An investment grade debt security is a non-convertible debt security having at least one nationally recognized statistical rating organization rate the security in one of its generic rating categories that signifies investment grade. Form F-3 could be used to issue non-convertible Eurobonds if the foreign private issuer has met the thirty-six month and annual reporting requirements.

54. SEC Form S-1, 17 C.F.R. § 239.11 (1983).

55. SEC Form S-2, 17 C.F.R. § 239.12 (1983).

56. SEC Form S-3, 17 C.F.R. § 239.13 (1983).

57. 17 C.F.R. §§ 239.31-239.33 (1983).

58. A foreign private issuer may not use SEC Form 20-F if more than fifty percent of its outstanding securities are held, directly or indirectly, by United States residents and its business is administered principally in the United States or fifty percent or more of the members of the Board of Directors are residents of the United States. 17 C.F.R. § 249.220f (1982). Most foreign finance subsidiaries of United States corporations fall within this category.

United States corporations issuing Eurobonds through foreign finance subsidiaries may not use form F-1, F-2 or F-3 but must use form S-1, S-2 or S-3 even though the bonds are issued by a foreign corporation.⁵⁹ Additionally, the domestic parent corporation's guarantee is a security which must be concurrently registered.⁶⁰

Corresponding to form F-3 is form S-3, which may be used to register non-convertible, investment grade debt securities. The Eurobonds issued by the foreign finance subsidiary and the parent-guarantee may both be registered on form S-3 if the parent meets the appropriate rating and reporting requirements.⁶¹ The reporting requirements are the same thirty-six month and annual report requirements as for form F-3.⁶² If the foreign finance subsidiary cannot meet the reporting requirements it is sufficient that requirements are met by the United States parent corporation.⁶³ The issue may still be registered on form S-3 even for non-investment grade securities if the aggregate market value of the voting stock of the domestic parent held by non-affiliates is at least \$150 million or at least \$100 million and has an annual trading volume of at least three million shares.⁶⁴

Since registration of Eurobond issues either by foreign private issuers on form F-3, or by foreign finance subsidiaries with domestic parent guarantees, is relatively easy to obtain, it is surprising that more issuers do not take advantage of it. A partial answer may be that even simplified registration takes time which would detract from the Eurobond market's potential for flexibility and quick reaction time. More importantly, registration brings foreign nationals into contact with the Securities and Exchange Commission and registration carries with it liabilities. The foreign underwriting groups would be particularly wary of section 11⁶⁵ of the 33 Act and possible deficiencies of the indenture trust under the Trust Indenture Act of 1939.⁶⁶

B. Potential Problems with Trust Indentures

As long as the Commission maintains its no-action stance on registration of Eurobonds, the Trust Indenture Act of 1939 does not

59. 17 C.F.R. § 249.220f (1982).

60. *See supra* note 30.

61. 17 C.F.R. § 239.13(c) (1983).

62. 17 C.F.R. § 239.13(a)(3) (1983).

63. 17 C.F.R. § 239.13(c)(2) (1983).

64. 17 C.F.R. § 239.13(b)(1) (1983).

65. 15 U.S.C. § 77k (1976).

66. 15 U.S.C. §§ 77aaa-77bbbb (1976).

pose any problems. However, should registration be required in the future, Trust Indenture Act provisions will become applicable, causing serious problems. Although a security may be registered under the Securities Act of 1933, it may not be offered for sale unless the trust indenture complies with the Trust Indenture Act of 1939.⁶⁷

The Trust Indenture Act applies to issues of bonds, debentures, notes, and similar debt securities issued under a trust indenture if more than \$10 million of the securities is outstanding at any one time.⁶⁸ The Act requires that the trustee be a corporation having minimum combined capital and surplus⁶⁹ and, in the event of default by the issuer, to exercise the rights, powers, and duties vested in it as a prudent person would in the conduct of their own affairs.⁷⁰

Nothing in British or civil law jurisdictions is comparable to the Trust Indenture Act. While it is common in the United Kingdom to draft a "trust deed," the thrust of the British regulatory scheme, which requires the indenture trustee to exercise a high degree of care, is different from that of the United States.⁷¹

The viability of all indenture trusts under civil law has been called into question as a result of the *Four Seasons*⁷² case in which a Luxembourg court refused to recognize an indenture trust because article 88 of the Luxembourg company law, an exhaustive enumeration of bond holder's rights,⁷³ did not include authorization for the trustee to pursue bondholder claims.

To prevent the loss of its Eurobond market, Luxembourg has since amended its law to allow use of an indenture trust;⁷⁴ however, the validity of indenture trusts in other civil law jurisdictions is highly suspect and presents another potential crisis for the Eurobond market. Issuers in civil law jurisdictions routinely execute trust deeds or indentures, and banks and other financial institutions in civil law ju-

67. 15 U.S.C. § 77eee(b) (1976).

68. 15 U.S.C. § 77ddd(a) (1981).

69. 15 U.S.C. § 77jjj (1981).

70. 15 U.S.C. § 77ooo(c) (1981).

71. See 7 HALSBURY'S LAWS OF ENGLAND, para. 816 (4th ed. 1974). British regulation consists of section 88 of the Companies Act of 1948 which prohibits indemnity provisions and trustee immunization clauses. Companies Act, 11 & 12 Geo. 6, ch. 38 (1948).

72. *Four Seasons Overseas N.V. v. S.A. Finimtrust*, Jan. 21, 1971, Tribunal d'arrondissement, Lux., 62 REVUE CRITIQUE DE DROIT INTERNATIONAL PRIVÉ [R.C.D.I.P.] 51 (1973).

73. *Id.* at 54-55.

74. Arrêté du grand-ducal du 22 decembre 1972 concernant la représentation fiduciaire, MEMORIAL [Off. Gaz.] Dec. 29, 1972, at 2113 (Lux.).

risdictions routinely serve as trustees.⁷⁵ They do so knowing that bondholders' rights are determined solely by reference to the commercial code of the jurisdiction in question. The crisis has been avoided so far by inserting choice-of-law clauses and other provisions into the underwriting agreements.⁷⁶

Most Eurobond underwriting agreements are written in the "firm commitment" style.⁷⁷ The underwriting banks purchase the bonds with the intention to resell to investors. The issuer assumes no responsibility for the qualification of the securities in any specific jurisdiction. The underwriters and sellers are responsible for compliance with local law. Hence, the underwriters and sellers are contractually responsible under the underwriting agreement for violations of United States securities laws.⁷⁸ All Eurobond underwriting agreements contain covenants to preclude any sales to United States nationals and covenants to preclude any sales in the United States, regardless of the purchaser's nationality, for at least ninety days following the completion of the distribution.⁷⁹ Confirmations of sales through dealers not in the selling group⁸⁰ contain a similar statement on non-sales.⁸¹ The underwriters are protected by a *force majeure* clause which gives them the right to terminate the underwriting agreement before closing if the issue would be prejudiced by a substantial change in national or international financial, political or economic conditions.⁸² Any change in status by the Commission would trigger the *force majeure* clauses of all agreements not yet closed.

If registration materials are filed for distribution within the United States, the issuer, underwriters and sellers are liable under section 11⁸³ of the 33 Act for omitting material facts or making false statements

75. Oppetit, *Le "trust" dans le droit du commerce international*, 62 R.C.D.I.P. 1, 7 (1973).

76. The underwriting agreements tend to be remarkably uniform. For a discussion of the problem of bondholder representation, see Note, *International Debt Obligations of Enterprises in Civil Law Countries: The Problem of Bondholder Representation*, 21 VA. J. INT'L L. 269 (1981).

77. The underwriters are principals rather than agents who assume the risk that the issue cannot be placed.

78. See Horn, *supra* note 27, at 761.

79. See *supra* text accompanying notes 39-41.

80. The selling group consists of the lead underwriter and other underwriters, primarily banks and other financial institutions, and dealers invited to join the syndicate.

81. See *supra* text accompanying notes 39-41.

82. See Horn, *supra* note 27, at 758-59.

83. 15 U.S.C. § 77k (1981). Section 11 provides in part that:

(a) In case any part of the registration statement, when such part became effective, contained an untrue statement of a material fact or omitted to state a material fact

in the registration statement. The potential for liability is increased because disclosure and accepted accounting principles differ from country to country. For example, the Item 17 and 18 financial statements included in form 20-F do not have to comply with Commission-approved, and generally accepted, accounting principles or Regulation S-X;⁸⁴ however, the certified statements and format of the financial statements must be the same as for United States issuers.⁸⁵ The Item 18 alternative of form 20-F is more extensive in its financial disclosure and more like the requirements of Regulation S-X. The importance of the higher disclosure standard for Item 18 is that this alternative is required for form 20-F for the year immediately preceding the filing of a form F-2 or F-3. If non-approved but generally accepted accounting principles are used in form 20-F, statements must be included setting forth material deviations from the Commission's generally accepted accounting principles.⁸⁶ Likewise, the balance sheet must be annotated to show any such variations.⁸⁷ The result of these requirements is that form 20-F must be completed with the same information required from United States issuers directly, or supplemented with such information.

Section 11 liability may also arise out of omissions or false statements contained in the explanations of deviations from United States approved generally accepted accounting principles.⁸⁸ The cost

required to be stated therein or necessary to make the statements therein not misleading, any person acquiring such security (unless it is proved that at the time of such acquisition he knew of such untruth or omission) may, either at law or in equity, in any court of competent jurisdiction, sue—

(1) every person who signed the registration statement;

(2) every person who was a director of (or person performing similar functions) or partner in the issuer at the time of the filing of the part of the registration statement with respect to which his liability is asserted;

(3) every person who, with his consent, is named in the registration statement as being or about to become a director, person performing similar functions, or partner;

(4) every accountant, engineer, or appraiser, or any person whose profession gives authority to a statement made by him, who has with his consent been named as having prepared or certified any part of the registration, or as having prepared or certified any report or valuation which is used in connection with the registration statement, with respect to the statement in such registration statement, report, or valuation, which purports to have been prepared or certified by him;

(5) every underwriter with respect to such security.

84. 17 C.F.R. § 210.04-01(a)(2) (1983).

85. Proposed § 3-19(a), Reg. S-X, Sec. Act. Rel. No. 6361, [1981-1982] FED. SEC. L. REP. (CCH) ¶ 83,055.

86. *Id.*

87. *Id.*

88. *Id.*

of compliance by foreign private issuers, coupled with potential section 11 liability, will result in foreign private issuers not registering Eurobond issues in the United States.

*C. Potential Problems with Extraterritorial Application
of United States Law*

Continued reliance on the Commission's no-action stance and nonregistration does not mean that issuers, underwriters and sellers are immune from liability under the securities laws. Multitudes of articles have been written on the extraterritorial application of United States securities laws.⁸⁹ Both the 33 and 34 Acts include in the definition of "interstate commerce" transactions between a foreign country and any state, territory or District of Columbia.⁹⁰ Federal courts have applied the antifraud provisions of the Acts extraterritorially.⁹¹

Extraterritorial application of the antifraud provisions appears to be expanding, and may indeed be codified in section 1905 of the proposed Federal Securities Code.⁹² Potential liability under United States securities laws hangs like a sword over the heads of issuers, underwriters and sellers of Eurobonds. Intrusion of United States regulatory power into the Eurobond market would have catastrophic effects on the ability of United States businesses to raise capital and on the free flow of international capital and trade.

IV. TAX IMPACT AS A DETERMINING FACTOR FOR
ISSUANCE

An essential element in successful marketing of a Eurobond issue is that the issuer must be able to pay interest without a withholding tax requirement. A Eurobond issue in which the issuer must withhold taxes on interest payable is simply not marketable, because the interest

89. See, e.g., Becker, *Extraterritorial Dimensions of the Securities Exchange Act*, 2 N.Y.U. J. INT'L L. & POL. 233 (1969); Curtis, *The Extraterritorial Application of the Federal Securities Code: A Further Analysis*, 9 CONN. L. REV. 67 (1976); Leigh, *Jurisdiction: Extraterritorial Application of United States Securities Laws*, 75 AM. J. INT'L L. 960 (1981); Norton, *Extraterritorial Jurisdiction of U.S. Antitrust and Securities Laws*, 28 INT'L & COMP. L.Q. 575 (1979).

90. 15 U.S.C. § 77b(7) (1976). 15 U.S.C. § 78c(17) (1976).

91. See, e.g., *IIT v. Cornfeld*, 619 F.2d 909 (2d Cir. 1980); *Bersch v. Drexel Firestone, Inc.*, 519 F.2d 974 (2d Cir. 1975), *cert. denied*, 423 U.S. 1018; *Leasco Data Processing Equipment Corp. v. Maxwell*, 468 F.2d 1326 (2d Cir. 1972); *Schoenbaum v. Firstbrook*, 405 F.2d 200 (2d Cir. 1968) *reh'g en banc.*, 405 F.2d 215, *cert. denied*, 395 U.S. 906.

92. American Law Institute, *Proposed Federal Securities Code*; (Proposed Official Draft 722-31) (May 19, 1978).

withholding tax must be borne by the issuer, making the issue too expensive. Furthermore, prospective bondholders want to remain outside national income and estate tax jurisdiction. Issuers want to benefit from a deduction for interest payments⁹³ or otherwise, minimize the tax consequences of an issue.

United States corporate Eurobond issuers were initially faced with sections 1441 and 1442 of the Internal Revenue Code⁹⁴ which provide for a withholding tax on interest paid from United States sources to nonresident alien individuals or foreign partnerships or corporations⁹⁵ of thirty percent.⁹⁶ In order to avoid the withholding requirements of sections 1441 and 1442, United States domestic corporations established offshore finance subsidiaries, some of which became Eurobond issuers. The offshore finance subsidiaries escaped the withholding requirement if less than twenty percent of their gross income was derived from United States sources.⁹⁷

Prior to the expiration of the Interest Equalization Tax on June 30, 1974, an offshore finance subsidiary was exempt from the withholding requirements of sections 1441 and 1442 if the finance subsidiary had a five-to-one debt-equity ratio.⁹⁸ Another consequence of the five-to-one debt-equity ratio was that the finance subsidiary's debt was deemed to be its own and not that of its parent; therefore, the Interest Equalization Tax did not apply to the offshore finance subsidiary.⁹⁹ When the Interest Equalization Tax expired so did the five-to-one debt-equity safe harbor from the withholding requirements of sections 1441 and 1442.¹⁰⁰ Revenue Rulings 74-464 and 74-620

93. I.R.C. § 163 (West 1982 & Supp. 1983). However, the deduction for interest paid on certain obligations in bearer form may be denied. If the obligation is a "registration-required obligation" no interest deduction is allowed unless the obligation is registered under the provisions of the Securities Act of 1933. An obligation is exempt from registration and its interest is deductible if: (1) the interest is not payable in the United States or one of its possessions; (2) the obligation on its face states that any United States person who holds the obligation will be subject to limitations under United States tax laws; and (3) arrangements are made not to sell the obligation to United States persons. I.R.C. § 163(f) (West Supp. 1983).

94. I.R.C. §§ 1441-1442 (West Supp. 1982).

95. I.R.C. § 861 (West 1982).

96. I.R.C. §§ 1441-1442 (West 1982); I.R.C. § 871(a)(1)(A); I.R.C. § 881(a)(1) (West 1982).

97. See Rev. Rul. 69-377, 1969-2 C.B. 231, 233.

98. Rev. Rul. 69-377, 1969-2 C.B. 231, 233; Rev. Rul. 69-501, 1969-2 C.B. 233, 234 (revoked in 1974).

99. *Id.*

100. Rev. Rul. 74-464, 1974-2 C.B. 46, 47; Rev. Rul. 74-620, 1974-2 C.B. 380, 381.

held that there was no reason to treat offshore finance subsidiaries differently from other corporations with respect to their corporate validity or their indebtedness.¹⁰¹ The interest withholding tax was reimposed on both the domestic parent and offshore finance subsidiary unless reduced or waived by a tax treaty.¹⁰²

The withholding tax may be imposed on the domestic parent either because the Eurobonds are deemed to be the parent's obligations, or because the parent borrowed the Eurobond issue proceeds from the offshore finance subsidiary and paid interest to the finance subsidiary. In the case of the former, the expiration of the five-to-one debt-equity safe harbor means that there is no articulated standard by which to determine whether the Eurobond issue constitutes debt of the offshore finance subsidiary or of the domestic parent corporation. Debt-equity ratios are no longer determinative; however, experience has shown that, as a rule of thumb, a two and one-half-to-one debt-equity ratio is acceptable.¹⁰³ The subsidiary must strictly adhere to corporate formalities and adequate capitalization to have its separate existence honored.¹⁰⁴ If, however, the debt is deemed to be the domestic parent's, only a favorable tax treaty can save the parent corporation from the withholding tax requirement.

One such favorable treaty is the income tax treaty between the United States and the Kingdom of the Netherlands,¹⁰⁵ ratified in 1948. When the Netherlands Antilles became autonomous in 1954, those benefits, with certain limitations, were extended by protocol to the Netherlands Antilles in 1955.¹⁰⁶ By extending the Netherlands treaty to include the Netherlands Antilles, that country has flourished as a Caribbean tax haven and has become a mecca for thousands of foreign

101. *Id.*

102. Under article 6, clause 2 of the United States Constitution, treaties to which the United States is a party have a status that is coequal with United States statutes. Internal Revenue Code Section 7852(d) provides that the code cannot abrogate any treaty in effect on August 16, 1954. The United States-Netherlands treaty was ratified in 1948, see *supra* note 1.

103. Newburg, *Financing in the Euromarket by U.S. Companies: A Survey of the Legal and Regulatory Framework*, 33 BUS. LAW. 2171, 2192 (1978).

104. *Id.*

105. Income Tax Convention, Apr. 29, 1948, United States-Netherlands, 62 Stat. 1757, T.I.A.S. No. 1855, T.D. 5778, 1950-1 C.B. 92.

106. Protocol Respecting Double Taxation: Income, June 15, 1955, United States-Netherlands, 6 U.S.T. 3696, T.I.A.S. No. 3366, T.D. 6153, 1955-2 C.B. 777. Subsequently modified by Protocol Respecting Double Taxation on Income, Oct. 23, 1963, United States-Netherlands, 15 U.S.T. 1900, T.I.A.S. No. 5665, 1965-1 C.B. 624.

companies seeking to take advantage of the favorable tax climate.¹⁰⁷

Offshore finance subsidiaries of United States domestic corporations inhabit the safe tax harbor of the Netherlands Antilles because of the United States-Netherlands Antilles tax treaty and the Netherlands Antilles municipal tax law. There are no withholding taxes on interest paid by a Netherlands Antilles corporation, nor any income tax on interest paid to nonresidents of the Netherlands Antilles.¹⁰⁸ Interest paid by a Netherlands Antilles corporation is exempt from United States tax unless the recipient is a citizen, resident or corporation of the United States.¹⁰⁹ Since sales of Eurobonds to United States citizens, residents or corporations are initially prohibited by the underwriting agreements, no United States tax liability arises until a United States resident, citizen or corporation acquires a Eurobond.

The Treasury Department has not been particularly happy with the United States-Netherlands Antilles tax treaty. The 1955 Protocol, which extended the Netherlands treaty to the Netherlands Antilles, was modified in 1963 to stop nationals of countries not a party to the treaty from taking advantage of the tax benefits. This modification stopped nationals of countries not party to the treaty from taking advantage of the treaty's tax benefits by establishing residency in the Netherlands Antilles either directly, through corporate subsidiaries, or indirectly, through holding companies which invest in either United States real property or in other investments.¹¹⁰

In 1971, the Internal Revenue Service issued Treasury Regulation Section 1.1441-6 which required the withholding agent for interest paid withhold the tax at the reduced rate (as provided by an applicable treaty) rather than the thirty or fourteen percent otherwise re-

107. Fialka, *Closing a Loophole*, Wall St. J., Oct. 11, 1982, at 1, col. 6.

108. Protocol Respecting Double Taxation: Income, June 15, 1955, United States-Netherlands, art. XII, 6 U.S.T. 3696, T.I.A.S. No. 3366, T.D. 6153, 1955-2 C.B. 777. Subsequently modified by Protocol Respecting Double Taxation on Income, Oct. 23, 1963, United States-Netherlands, 15 U.S.T. 1900, T.I.A.S. No. 5665, 1965-1 C.B. 624 (this treaty incorporates the Income Tax Convention, Apr. 29, 1948, United States-Netherlands, 62 Stat. 1757, T.I.A.S. No. 1855, T.D. 5778, 1950-1 C.B. 92). A minimal tax of a maximum of three percent is imposed on Netherlands Antilles holding companies. Arts. XIII and XIV, Netherlands Antilles National Ordinance on Profit Tax of 1940.

109. Protocol Respecting Double Taxation: Income, June 15, 1955, United States-Netherlands, arts. VII and XII, 6 U.S.T. 3696, T.I.A.S. No. 3366, T.D. 6153, 1955-2 C.B. 777.

110. 1965-1 C.B. 624.

quired.¹¹¹ The regulation's effect is that no withholding is required on interest paid to a Netherlands Antilles corporation; therefore, the interest paid by a United States parent corporation to its Netherlands Antilles finance subsidiary is tax free. This tax relief is a necessary condition for the issuance of the Eurobonds.

If part of a Eurobond issue ultimately comes into the hands of persons subject to United States tax jurisdiction, the interest paid by a Netherlands Antilles corporation is not exempt from United States taxation.¹¹² However, the tax is easily avoided, because the IRS cannot identify Eurobond holders subject to the United States tax jurisdiction. In an effort to police the treaty provisions, the Treasury Department issued Revenue Procedure 79-40.¹¹³ Revenue Procedure 79-40 provides that the thirty percent withholding tax is applicable to interest paid to a Netherlands Antilles corporation unless the withholding agent receives a certificate of status from the Inspector of Taxes of the Netherlands Antilles certifying the payee's residency.

Controversy immediately erupted. Revenue Procedure 79-40 clearly exceeded the requirements of Treasury Regulation Section 1.1441-6 by requiring the submission of certain certificates of status as a condition for exemption from the withholding requirements of sections 1441 and 1442.¹¹⁴ Furthermore, the revenue procedure required persons receiving interest from a Netherlands Antilles corporation to disclose certain information as a condition for issuing a ruling that the interest payments were exempt from withholding.¹¹⁵ An opinion issued by the Commissioner of Internal Revenue on January 19, 1979 stated that Treasury Regulation Section 1.441-6 did not preclude the IRS from requiring the certificates of status if exemptions from withholding tax on interest paid to a Netherlands Antilles corporation were claimed. Additionally, the opinion stated that in certain cases a ruling would be necessary to obtain the exemption from withholding of tax from interest payments made to a Netherlands Antilles corporation, and the information requested for ruling purposes should

111. To qualify for the withholding tax exemption for interest paid pursuant to a United States treaty provision the recipient of the interest must file an Ownership, Exemption, or Reduced Rate Certificate (Form 1001) with the withholding agent. The certificate is effective for a three year period provided the recipient remains eligible for the exemption during that period. Treas. Reg. § 1.1441-6(c) (1971).

112. *See supra* note 109.

113. Rev. Proc. 79-40, 1979-2 C.B. 504.

114. Treas. Reg. § 1.1441-6(c)(1) only requires filing Form 1001 (Ownership, Exemptions or Reduced Rate Certificate).

115. Rev. Proc. 79-40, 1979-2 C.B. 505-06.

coincide with the requirements of the protocol.¹¹⁶

Since 1974, the IRS has refused to issue private letter rulings concerning offshore finance subsidiaries.¹¹⁷ Moreover, it announced that it was not bound by any private letter ruling previously issued,¹¹⁸ although it did confirm an unpublished 1973 private letter ruling stating that interest paid by a Netherlands Antilles finance subsidiary to non-United States persons was exempt from taxation.¹¹⁹ While the IRS no longer issues such private letter rulings, private law firms issue opinion letters on this subject with regularity.¹²⁰

At the same time that the Treasury Department has been trying to close the Netherlands Antilles "loophole" to businesses, the Federal National Mortgage Association (Fannie Mae), a government agency, has been trying to take advantage of the tax benefits of the treaty.¹²¹ Fannie Mae formed a Netherlands Antilles corporation, FNM Overseas Capital Corp., N.V., which in 1978 purchased "fully-modified pass-through" mortgage-backed certificates.¹²² Revenue Ruling 79-251 held that the interest paid to the Netherlands Antilles corporation was exempt from federal taxation pursuant to article VIII(1) of the treaty.¹²³ In 1983, Fannie Mae wanted to use its offshore corporation to attract foreign funds to the United States mortgage market. In a letter from Secretary of the Treasury Donald T. Regan to Fannie Mae Chairman David O. Maxwell, the request was denied on the grounds that it might adversely affect treaty negotiations.¹²⁴

Treaty negotiations between the United States and the Netherlands Antilles have been going on for a protracted length of time without result. The United States wants to renegotiate or cancel the treaty as it did with the British Virgin Islands.¹²⁵ The Netherlands Antilles

116. 26 C.F.R. § 505.301 (1983).

117. See *supra* note 100.

118. *Id.*

119. 1980 FED. TAXES (P-H) [¶ 4949 (80)] (this private letter ruling refers to the letter ruling from Aug. 13, 1973 [¶ 41,861 (73)]).

120. Fialka, *supra* note 107, at 14, col. 2.

121. Rev. Rul. 79-251, 1979-2 C.B. 271.

122. *Id.* at 272.

123. *Id.* at 273.

124. Letter from Secretary of the Treasury Donald T. Regan to Fannie Mae Chairman David O. Maxwell (Mar. 9, 1983), reprinted in [1983] DAILY TAX REP. (BNA) No. 83, at G-6, G-7.

125. [1983] DAILY TAX REP. (BNA) No. 72, at G-6. Article XXIV of the British Virgin Islands tax treaty provided for termination by either party giving notice on or before June 30 of any year to become effective on January 1 of the following year. Convention on Double Taxation, Apr. 16, 1945, United States-United Kingdom, art. XXIV, 60 Stat.

wants to retain the treaty because it has become increasingly dependent on the \$50 to \$100 million in annual tax revenues from offshore finance subsidiaries.¹²⁶

The IRS has alleged widespread abuse of the treaty.¹²⁷ The 1963 Protocol did not end third party abuse of the treaty provisions, including the practice of setting up a Netherlands Antilles corporation to make investments in the United States.¹²⁸ The treaty, in combination with bank secrecy laws and lack of cooperation by Netherlands Antilles officials, allows the laundering of funds earned through illegal activities, and provides opportunities for tax evasion.¹²⁹ IRS officials have stated that the Treasury Department will not hesitate to cancel the treaty unless it is modified to prevent treaty shopping by third parties and to provide better information exchange provisions.¹³⁰

The Netherlands Antilles complains of the limited, tax-oriented view taken by the Treasury and insists that the treaty be reviewed as a matter of foreign policy.¹³¹ Cancellation of the treaty may result in economic disaster and social unrest in both the Netherlands Antilles and the United States.¹³² Furthermore, the Netherlands Antilles charges that the Treasury Department's position is inconsistent with President Reagan's Caribbean Basin Incentive.¹³³

Cancellation of the treaty would cause serious financial problems in the Eurobond market. Imposition of the thirty percent withholding tax on cancellation of the treaty would drive up the cost of borrowing money by increasing interest rates. This cost would have to be absorbed by the borrower. Some United States corporations are requiring escape clauses in debt issues to allow for immediate refinancing in case the treaty is either cancelled or substantially modified

1377, T.I.A.S. No. 1546, *extended to* British Virgin Islands by Second Protocol, May 25, 1954, T.I.A.S. No. 3165, and *modified by* Third Protocol, Aug. 19, 1957, T.I.A.S. No. 4124. The treaty was terminated by the United States on June 30, 1982 effective January 1, 1983. [1983] FED. TAXES (P-H) ¶ 42,911.

126. Statement of Harold Henriquez, Minister Plenipotentiary for Netherlands Antilles affairs, [1983] DAILY TAX REP. (BNA) No. 45, at G-7.

127. Testimony of Assistant Secretary for Tax Policy, John E. Chapoton before the House Government Affairs, Commerce, Consumer and Monetary Affairs Subcomm., Apr. 13, 1983, *reprinted in* [1983] DAILY TAX REP. (BNA) No. 72, at G-6; [1983] DAILY TAX REP. (BNA) No. 45, at G-7; [1983] DAILY TAX REP. (BNA) No. 71, at G-5.

128. [1983] DAILY TAX REP. (BNA) No. 71, at G-5.

129. *See* Testimony of John E. Chapoton, *supra* note 127, at G-6.

130. *Id.*

131. Statement of Harold Henriquez, *supra* note 126, at G-7.

132. *Id.*

133. *Id.*

in a way which threatens to increase the interest rate.¹³⁴ The treaty's cancellation or modification must be done in such a way as to lessen the economic and social impact in both the Netherlands Antilles and the United States. If the treaty is cancelled, one alternative is to "grandfather" all outstanding debt until maturity and provide benefits to the Netherlands Antilles under the Caribbean Basin Incentives proposal. Modification of the treaty to provide for greater information flow and restrictions on usage by third parties could leave the offshore finance subsidiary scheme intact without harming the economy of the Netherlands Antilles.

Repeal of the thirty percent withholding tax for interest paid on Eurobonds would accomplish the same tax result with respect to United States corporations, and would allow direct access to the Eurobond market without the need for an offshore finance subsidiary. The Treasury Department is in favor of repealing the thirty percent withholding tax on Eurobond interest paid by United States corporations, and bills to repeal the withholding tax have been introduced in both the Senate and House of Representatives.¹³⁵ However, repeal would divert more than \$100 million from the Netherlands Antilles treasury to the United States treasury and seriously disrupt the economy of the Netherlands Antilles. Furthermore, repeal of the thirty percent withholding tax on interest paid by United States corporations on Eurobond debt could be embarrassing to an Administration that has insisted on a domestic withholding tax on interest paid.¹³⁶ However, repeal of domestic withholding rules would make the repeal of the withholding tax on Eurobond issues more palatable.¹³⁷

V. CONCLUSION

Today the size of the Eurobond market for debt issued by United States corporations is roughly equal to the size of the domestic market. Moreover, the cost of financing debt in the Eurobond market is lower

134. [1983] DAILY TAX REP. (BNA) No. 43, at G-3 and G-4.

135. H.R. 3025, 98th Cong., 1st Sess. (1983); S. 1557, 98th Cong., 1st Sess. (1983). The Reagan Administration is reportedly in favor of repeal of the thirty percent withholding on interest. Letter from Assistant Secretary of the Treasury John E. Chapoton to Representative Sam M. Gibbons, *reprinted in* [1983] DAILY TAX REP. (BNA) No. 108, at G-5 and G-6.

136. I.R.C. § 3451 (repealed in 1983), reenacted as section 301; Tax Equity and Fiscal Responsibility Act of 1982. This provision was never put into effect due to heavy pressure from the banking industry.

137. H.R. 2973, 98th Cong., 1st Sess. (1983), signed by President Reagan on August 5, 1983.

than the cost in the domestic market. However, the attractiveness of the Eurobond market is marred by the threat of unilateral regulation of that market by either the Securities and Exchange Commission or the Internal Revenue Service, or both.

The Securities and Exchange Commission should clarify its position with respect to the secondary market of Eurobonds in the United States, resolve the doubts, and allay the fears of issuers, underwriters, and sellers with respect to potential liability under United States securities laws. The Treasury should seek modification of the United States-Netherlands Antilles treaty in such a way as to preserve the economic and social status quo in the Netherlands Antilles and to preserve the viability of the Eurobond market. Cancellation of the treaty, if it cannot be satisfactorily modified, should be coupled not only with the repeal of the thirty percent withholding tax on Eurobond interest paid by United States corporations, but also with aid to the Netherlands Antilles, either directly, or through the Caribbean Basin Incentives program.

Policy makers must realize that corporate finance is international finance and that international finance should not be frustrated by the regulatory scheme of any state, particularly if that scheme is not subscribed to by other participating states. The United States is a part of the international financial community and must be a responsible member of that community.

